Supreme Court, U.S.
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In The

Supreme Court of the United States

MICHIGAN STATE UNEMPLOYMENT AGENCY, DEPARTMENT OF CONSUMER & INDUSTRY SERVICES,

Petitioner,

v.

RANDALL L. FRANK, Trustee,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Does a valid, properly perfected, prepetition statutory tax lien of the Michigan Employment Security Commission (now the Michigan Unemployment Agency) against a prepetition debtor attach to postpetition preference action recoveries made under 11 U.S.C. § 547(1986) by a Chapter 7 bankruptcy trustee?

PARTIES TO THE PROCEEDING

The parties to this proceeding are Randall L. Frank, Chapter 7 Trustee, Respondent, Plaintiff below, and the Michigan Unemployment Agency, as Petitioner, Defendant below. This proceeding arose within the Chapter 7 Bankruptcy case of Thompson Boat Company, Case No. 93-20546, pending in the United States Bankruptcy Court for the Eastern District of Michigan, Northern Division.

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Opinion of the District Court	261 B.R. 909 (E.D. Mich. 2000)
Opinion of the Bankruptcy Court	Unreported

COUNTER-STATEMENT OF THE CASE

The Michigan Employment Security Commission, now known as the Michigan Unemployment Agency ("UA"), held a prepetition statutory tax lien against Thompson Boat Company ("Thompson Boat") for unemployment taxes. This tax lien arose under Mich. Comp. Laws § 421.15(e) (1992) which provides for a lien that attaches to "all property and rights to property" of the Debtor. The lien was properly perfected by recording with the Register of Deeds, giving the lien priority over any subsequently filed liens. Mich. Comp. Laws § 421.15(e). Under this section, "the lien shall *attach* to the property and rights to property of the employer . . . whether real or personal. . . . " The UA claims a secured claim of about $230,000.

On May 19, 1993, Thompson Boat filed its Chapter 11 bankruptcy petition and its case was converted to Chapter 7 on August 19, 1994. Randall L. Frank ("Trustee") was appointed as the Chapter 7 trustee and he remains the trustee. The Trustee's administration of the Thompson Boat bankruptcy case included the recovery of "preferences" under 11 U.S.C. § 547 and 11 U.S.C. § 551 (1978) in excess of $300,000. These recoveries were from parties who were creditors of Thompson Boat during the preference period that received payments against balances due them ("preference recoveries"). The UA acknowledges that it had no state law power to recover these preferences outside bankruptcy.

The Trustee asserted that the UA's prepetition lien did not attach to the preference recoveries. The United States Bankruptcy Court for the Eastern District of Michigan, Northern Division, Honorable Arthur J. Spector, ruled in favor of the Trustee and determined that the UA lien did not attach to the preference recoveries. That decision was upheld by the United States District Court for the Eastern District of Michigan, Honorable Victoria A. Roberts, and subsequently by the Court of Appeals for the Sixth Circuit. The UA has petitioned for review by this Court.

REASONS TO DENY THE WRIT

1. SUMMARY OF ARGUMENT

The decision of the Sixth Circuit is in accord with existing precedent and respects the validity of liens that have properly attached to assets. In the underlying case,

the UA's lien was not effective against the third parties that were paid prepetition by Thompson Boat because the UA had no legal basis to recover money from the recipient. Further, the UA's lien did not "reattach" after the Trustee applied the Bankruptcy Code preference statute to recover money from the recipient.

2. THE LOWER COURT'S DECISION DOES NOT DEPART FROM PRECEDENT.

The Sixth Circuit did not depart from established precedent in its decision. The cases cited by the UA established that property subject to a valid lien generally remains subject to that lien when a bankruptcy is filed. This principle is untouched by the decision in this case because none of the cited cases involve preference recoveries.

The UA cited four Supreme Court cases as its basis for claiming that the decision of the Sixth Circuit departs from established precedent. In *Long v. Bullard*, 117 U.S. 617, 620-621, 6 S.Ct. 917, 918, 29 L.Ed. 1004 (1886) this Court held that a prepetition lien passes through bankruptcy unaffected. The Sixth Circuit decision is in accord with *Long*. The lower court found that the UA lien is unaffected by the Thompson Boat bankruptcy, and further, that it is also not "enhanced" by the bankruptcy to cover preference recoveries.

In a similar "controlling" precedent raised by the UA, this Court stated that once attached, a lien follows property wherever transferred. *United States v. Bess*, 357 U.S. 51, 57, 78 S.Ct. 1054, 1058, 2 L.Ed.2d 1135 (1958). As indicated above, the UA does not assert that it had an

enforceable lien on the funds in the hands of creditors receiving payment from the Debtor, so the principle espoused in *United States v. Bess* has no bearing on the facts of this case. The UA's lien ceased to exist when the funds paid by the debtor were received by the creditor. In fact, *United States v. Bess* supports the decision in this case. In that case, this Court held that because the owner of the life insurance policies at issue had no "property" interest in the death benefit payable upon his death, the Internal Revenue Service lien against all of the decedent's assets *did not attach* to the death benefit payable to his beneficiary. This holding recognizes that unless the lien has attached to property belonging to the debtor, the lien is not effective.

The UA's third "controlling" case is *Michigan v. United States*, 317 U.S. 338, 63 S.Ct. 302, 87 L.Ed. 312 (1943). *Michigan* simply stands for the already discussed principle that once a lien attaches, it remains attached even if the property is transferred. *Michigan*, 317 U.S. at 340. Again, the UA does not assert that it had an enforceable lien on money in the hands of the creditors receiving payment from the debtor.

Last, in *Johnson v. Home State Bank*, 501 U.S. 78, 85, 111 S.Ct. 2150, 2155, 115 L.Ed.2d 66 (1991), this Court stated that a non-recourse lien is a "claim" for bankruptcy purposes. This principle is unaffected by the Sixth Circuit's decision that the lien does not attach to preference recoveries.

Thus, the lower courts have followed the controlling precedent pointed out by the UA. This Court has not

previously addressed the direct issue of whether a prepetition statutory lien attaches to preference recoveries and the Sixth Circuit is the only circuit to do so to date. Such a first-of-its-kind ruling is not the kind of decision this Court historically reviews, especially where there is no error in the courts below, as in this case.

3. PREPETITION LIEN NOT ATTACHED AT TIME OF BANKRUPTCY FILING.

Under the statute at issue in this case, Mich. Comp. Laws § 421.15(e), the UA's lien attaches to "all property and rights to property, real and personal, belonging to the employer." In this case, the employer/debtor had no "right to" the money it had paid out prepetition once paid to a creditor. The lien was extinguished as to these funds. The UA has pointed to no legal authority to the contrary. As a result, the UA had no lien on potential preference recoveries at the time of the bankruptcy filing.

The UA conveniently avoids the fact that at the time of bankruptcy filing, the UA lien was not an encumbrance against the money Thompson Boat had paid recipients prepetition because the money was not its property. This fact destroys the UA's case. The UA has cited no Michigan law that provides for the position it now takes with regard to its lien. Further, no Michigan case provides for the continuation of a lien on money transferred by a debtor to a recipient for a legitimate business purpose. No reported Michigan decision indicates that the UA has ever tried to recover money transferred by a debtor to a recipient. This is because no lien rights attach to money once paid to third parties.

4. A TRUSTEE HAS POWERS INDEPENDENT OF THOSE OF DEBTORS.

The UA contends that the Trustee stands in the shoes of the debtor. While this proposition is true, a Chapter 7 trustee also has powers independent of those of a debtor.

Relevant in this case is the Trustee's statutory power to recover payments made to third parties by a debtor during a period termed the "preference period." See 11 U.S.C. § 547. This recovery power was not available to a debtor or a creditor under Michigan law at the time of the Bankruptcy filing.[1] Also, this power is not available to individual creditors in a bankruptcy case, and is not available to the debtor that has filed bankruptcy. *In re Natchez Corp. of W. Va.*, 953 F.2d 184, 187 (5th Cir. 1992).

The trustee, as plaintiff in a preference case, stands as a representative of the bankruptcy estate, not as a representative of the debtor. Contrary to the UA's assertions, this added power granted to a trustee is the basis for the Sixth Circuit decision in this case.

5. THERE IS AN ESTATE/DEBTOR DICHOTOMY.

While the debtor's assets usually become part of the bankruptcy estate's assets, there are instances where the

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[1] Michigan law now provides for limited rights to recover preferential payments. Mich. Comp. Laws §§ 566.31-566.43 (1998).

estate's assets are entirely separate. Certainly, liens continue to encumber the debtor's assets when, upon bankruptcy filing, they enter the bankruptcy estate. In contrast, the assets in question in this case – preference recoveries – exist only *within* a bankruptcy estate.

No court has ever rejected the estate/debtor dichotomy in the context of preference actions taken by a trustee. This Court addressed the estate/debtor dichotomy with regard to collective bargaining agreements in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528, 104 S.Ct. 1188, 1197, 79 L.Ed.2d 482 (1984). Under the circumstances in that case, this Court stated:

> For our purposes, it is sensible to view the debtor-in-possession as the same "entity" which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing.

In this case, the lower court took note of the *NLRB v. Bildisco & Bildisco* holding. It determined that a distinction exists between the *NLRB v. Bildisco & Bildisco* executory contract context under 11 U.S.C. § 365 (1992) and the preference action context in this case. Executory contracts exist prepetition and flow into the bankruptcy estate subject to new restrictions and powers arising from the Bankruptcy Code. Preference actions have no existence prepetition and arise only within a bankruptcy case because of specific powers granted to a trustee under § 547.

Further, the Bankruptcy Code clearly provides that a debtor does not have an interest in money recovered from

a preference action because the avoided transfer is "preserved for the benefit of the estate." 11 U.S.C. § 551. Also, § 552 of the Bankruptcy Code recognizes a distinction between the estate and the debtor. That section discusses the effect of a security agreement on two groups of assets:

> A. those acquired by the *estate* after commencement of a bankruptcy case, and
>
> B. those acquired by the *debtor* after commencement of a bankruptcy case.

11 U.S.C. § 552(a) (1984).

Judge Spector in *In re Winom Tool and Die, Inc.*, 173 B.R. 613 (Bankr. E.D. Mich. 1994) set forth a clear analysis of the dichotomy in the context of whether property remains within the bankruptcy estate or revests in the debtor upon confirmation of a Chapter 11 plan. The bankruptcy court concluded in that case that property "may be held by a post-petition debtor in its own right (non-estate property) or as debtor in possession (estate property)." *In re Winom Tool and Die, Inc.*, 173 B.R. at 624-625.

The UA relies on *In re Ferguson*, 197 B.R. 161 (Bankr. S.D. Fla. 1996) for its position that tax liens extend to preference recoveries. While the *Ferguson* court held so, it provided no analysis to support its position and was commenting on the breadth of a tax lien with regard to preference recoveries made in an earlier and separate bankruptcy case that had been filed by the debtor and that was closed. See, *Ferguson*, 197 B.R. at 163. *Ferguson* is thus easily distinguishable and provides no persuasive authority in this case.

The UA also relies on *In re National Financial Alternatives, Inc.*, 96 B.R. 844 (Bankr. N.D. Ill. 1989). This case is also distinguishable because it did not involve the preference action context. As recognized by Judge Spector, below, the *National Financial* case limited its analysis to the effect of 11 U.S.C. § 552.

The arguments of the UA are unpersuasive and fail to build a basis to question the Sixth Circuit decision. The UA is seeking to elevate its prepetition lien rights that are governed by Michigan law into a type of "super-lien" that can attach to property the Debtor could not own (the preference recoveries).

CONCLUSION

No compelling reason exists for granting the UA's Petition. Therefore the Trustee requests denial of the Petition for a Writ of Certiorari.

Dated: November 12, 2001

Respectfully submitted,

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